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October 6, 2004

By Hand Delivery

Mary L. Cottrell, Secretary  
Department of Telecommunications and Energy  
One South Station, 2<sup>nd</sup> floor  
Boston, MA 02110

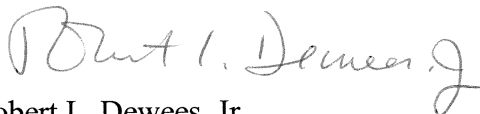
Re: Bay State Gas Company, D.T.E. 04-80

Dear Ms. Cottrell:

Enclosed is the Brief of Bay State Gas Company.

Please contact me if you have any questions.

Very truly yours,



Robert L. Dewees, Jr.

RLD/tlm  
Enclosures

cc: Marcella Hickey, Hearing Officer  
Paul Osborne, Assistant Director, Rates and Revenue Requirements  
Tom Carey, Analyst, Rates and Revenue Requirements  
Cynthia Bradbury, Analyst, Gas Division  
James H. Keshian

BOS1424311.1

**COMMONWEALTH OF MASSACHUSETTS**  
**DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY**

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BAY STATE GAS COMPANY	)	D.T.E. 04-80
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**BRIEF OF  
BAY STATE GAS COMPANY**

**I. INTRODUCTION**

On August 19, 2004, Bay State Gas Company (“Bay State” or the “Company”) filed a request for authorization pursuant to G.L. c. 164, §§ 14 and 15 to issue and sell long term unsecured debt in an aggregate amount not to exceed \$120,000,000, at face value, to its affiliate, NiSource Finance Corp. The Department conducted public and evidentiary hearings at its offices on September 28, 2004, at which the Company sponsored the testimony of its Assistant Treasurer, Vincent Rea. The evidentiary record consists of Bay State’s initial petition (Ex. BSG-10), the Direct Testimony of Vincent Rea, including exhibits, (Exs. BSG-1 through BSG-9), responses to the Department’s information requests (Exs. DTE 1-1 through 1-17) and responses to the Department’s record requests (DTE RR-1 and DTE RR-2). In accordance with the schedule set by the Hearing Officer, Bay State submits this Brief.

**II. DESCRIPTION OF THE PROPOSED FINANCING**

**A. Up to \$120,000,000 in Long Term Notes**

Bay State is proposing to issue long term debt, in the form of promissory notes (“Notes”), to its affiliate, NiSource Finance Corp., in an amount not to exceed \$120,000,000. The net effect

of the proposed financing will be a \$110,000,000 increase to the Company's long term debt, because \$10 million of the proceeds will be used to refinance a long term note that will mature in June, 2005. The Company proposes to issue the Notes over an eighteen (18) month period following the Department's approval of the Company's proposed financing. The Notes may be issued for terms of ten, fifteen or twenty years. The Company anticipates issuing up to \$90 million of the proposed financing before December 31, 2004. Ex. BSG-1, p. 3.

The interest rate for each Note will be fixed at the time of issuance and will be a market-based rate similar to the rates offered to companies with financial profiles similar to Bay State's. The interest rates for the Notes will be determined by the applicable Treasury bond yield (as reported in the Federal Reserve Statistical Release, H.15, Selected Interest Rates, Daily) effective on the date a Note is issued, plus the yield spread on corresponding bond maturities for utilities with a credit risk profile equivalent to the Company's (as reported by Reuters Corporate Spreads for Utilities) effective on the date a Note is issued. The Reuters Corporate Spreads for Utilities assigns yield spreads based on a company's Standard and Poors and Moodys debt credit ratings. The Company's senior secured debt is currently rated BBB by Standard and Poors and Baa2 by Moodys, both with a stable outlook. Ex. BSG-1, p. 5; Ex. DTE 1-3; Ex. DTE 1-6. For maturities not specifically referenced in the Federal Reserve Statistical Release or Reuters Corporate Spreads, the Company will calculate the interest rate based upon a simple linear interpolation method. Ex. BSG-1, p. 5; Ex. DTE 1-7. In addition, according to the rules promulgated under The Public Utility Holding Company Act of 1935 and Securities and Exchange Commission policies, the interest rate that a Note will bear will reflect no mark-up by the lender, NiSource Finance Corp. Ex. BSG-1, p. 5; Tr. at 23-24.

The Department approved a very similar financing for Bay State in 2002. Ex. BSG-1, p. 8; Bay State Gas Company, D.T.E. 02-73.

## **B. Use of Proceeds from Issuance of the Notes**

The purpose for the proposed financing is to fund long term utility assets of the Company with long term debt and to move the Company toward its targeted capital structure. Ex. BSG-1, p. 4.

The Company anticipates using the proceeds as follows: \$37 million of the proceeds will be used to refinance long term debt maturities and early redemptions which have occurred over the preceding fourteen months and which have temporarily been converted to short term debt; \$53 million of the proceeds will be used to refinance additional short term debt that currently supports long term utility plant assets. The remaining proceeds from the proposed transaction will be used to refinance an upcoming long term maturity of \$10 million (which will occur in June, 2005) and to fund normal capital requirements necessary for the Company's public service obligations. Ex. BSG-1, p. 4; Ex. DTE 1-1; Ex. DTE 1-2.

## **III. STANDARD OF REVIEW**

To approve a gas or electric company's issuance of stocks, bonds, coupon notes or other types of indebtedness for periods in excess of one year, the Department will examine whether the proposed issuance satisfies two requirements. First, the Department considers whether the issuance is reasonably necessary to accomplish some legitimate purpose in meeting a company's service obligations, pursuant to G.L. c. 164, § 14. Fitchburg Gas & Electric Light Company v. Department of Public Utilities, 395 Mass. 836, 842 (1985) ("Fitchburg II"), citing Fitchburg Gas & Electric Light Company v. Department of Public Utilities, 394 Mass. 671, 678 (1985) ("Fitchburg I"). Second, the Department will consider whether the Company has satisfied the net plant test. Colonial Gas Company, D.P.U. 84-96 (1984). If the Department finds it to be in the public interest, it may also grant an exemption from the requirement of G.L. c. 164, § 15 that an issuance of long term debt be publicly advertised.

For purposes of G.L. c. 164, § 14, the Supreme Judicial Court has found that “reasonably necessary” means “reasonably necessary for the accomplishment of some purpose having to do with the obligations of the company to the public and its ability to carry out those obligations with the greatest possible efficiency.” Fitchburg II at 836, citing Lowell Gas Light Company v. Department of Public Utilities, 319 Mass. 46, 52 (1946). Where no issue exists as to the reasonableness of management decisions regarding the requested financing, the Department will limit its Section 14 review to the facial reasonableness of the purpose to which the proceeds of the proposed issuance will be put. Commonwealth Electric Company, d/b/a NStar Electric, D.T.E. 02-51, at 4, (2002) citing Canal Electric Company, et al. D.P.U. 84-152, at 20 (1984); Colonial Gas Company, D.P.U. 90-50, at 6 (1990).

With respect to the net plant test, which is derived from G.L. c. 164, § 16, a company is required to present evidence that its net utility plant (original cost of capitalizable plant, less accumulated depreciation) equals or exceeds its total capitalization (the sum of its long term debt and its preferred and common stock outstanding) and will continue to do so following the proposed issuance. Commonwealth Electric Company, d/b/a NStar Electric, D.T.E. 02-51, at 4, citing Colonial Gas Company, D.P.U. 84-96, at 5 (1984). Specifically, under the net plant test, the Department examines whether the fair structural value of the plant and land and the fair value of the gas inventories owned by the company exceeds the company’s outstanding stock and long term debt. Commonwealth Electric Company, d/b/a NStar Electric, D.T.E. 02-51, at 3 n. 3.

G.L. c. 164, § 15 provides that a gas or electric company issuing long term bonds or notes, in excess of \$1 million payable at periods of more than five years after the date of issuance, invite purchase proposals through newspaper advertisements. The Department may grant an exemption from this advertising requirement if it finds that an exemption is in the public interest. The Department has found it in the public interest to grant an exemption from the

advertising requirement where there has been a measure of competition in private placement. Western Massachusetts Electric Company, D.P.U. 88-32, at 5 (1988); Eastern Edison Company, D.P.U. 88-127, at 11-12 (1988); Berkshire Gas Company, D.P.U. 89-12, at 11 (1989). The Department also has found that it is in the public interest to grant a company an exemption from the advertising requirement when a measure of flexibility is necessary in order for a company to enter the bond market in a timely manner. Western Massachusetts Electric Company, D.P.U. 88-32, at 5 (1988); Bay State Gas Company, D.P.U. 93-14, at 4 (1993).

The Department has found that the “purpose behind G.L. c. 164, § 15 is to promote a competitive debt market, with the intent of creating lower debt costs for utilities and subsequent savings to ratepayers.” MECo/EUA Merger, D.T.E. 99-47.

#### **IV. BAY STATE’S PROPOSAL IS CONSISTENT WITH THE DEPARTMENT’S STANDARDS OF REVIEW**

##### **A. Bay State’s Proposed Issuance is Reasonably Necessary to Meet its Public Service Obligations**

Bay State has demonstrated that the issuance of up to \$120,000,000 in long term Notes is reasonably necessary to accomplish a legitimate purpose in meeting the Company’s service obligations pursuant to G.L. c. 164, § 14. The Company will use the proceeds of the Notes to pay down short term debt and to refinance recently matured, as well as soon to mature, long term debt. These purposes are consistent with purposes previously approved by the Department. See, e.g., Berkshire Gas Company, D.T.E. 98-129, at 8 (1999); New England Power Company, D.P.U. 95-101 (1995). Bay State has also demonstrated that its proposed debt issuance will occur at very favorable interest rates for the Company. The interest rates on the Notes will be market-based and tied to the applicable Treasury bond rate in effect at the time, adjusted to reflect the premium associated with the Company’s credit risk profile. Ex. BSG-1, p. 5. This will result in the Company obtaining “the most competitive pricing” for the Notes (Tr. at 18) and

will help Bay State fulfill its public service obligations by keeping financing costs as low as possible.

The proposed financing will also move the Company toward a more favorable capital structure by reducing short term debt and increasing long term debt. Ex. BSG-1, p. 7.

Therefore, the proposed financing offers the most cost-effective means of issuing long term debt, and is consistent with the obligations of the Company to its customers.

**B. Bay State Meets the Department's Net Plant Test**

Bay State's capital structure will continue to meet the Department's net plant test if the proposed issuance is approved. As of June 30, 2004, and assuming a \$110 million net increase in long term debt, net utility plant will exceed total capitalization by \$127,085,167. Ex. BSG-7. As of December 31, 2004 on a pro forma basis, also assuming a \$110 million net increase in long term debt, net utility plant will exceed total capitalization by \$140,526,275. Ex. BSG-7A.

Following the Department's standards, the Company adjusted utility plant to reflect only the assets related to utility operations of the Company by removing plant associated with subsidiaries. In addition, construction work in progress ("CWIP") has been removed as has any acquisition premium related to the merger with NiSource, Inc. Ex. BSG-7; Ex. DTE 1-12. Gas inventories are valued at the weighted average cost of gas. Ex. DTE 1-15.

The Company adjusted capitalization by excluding retained earnings, investments in subsidiaries, and any acquisition premium associated with the merger with NiSource, Inc. Ex. BSG-7; Ex. DTE 1-14. Southern Union Company, D.T.E. 04-36, at 5-6, (2004).

Capitalization includes long term debt maturing within one year. Ex. DTE 1-13.

**C. Exemption from the Advertising Requirements of G.L. c. 164, § 15 is in the Public Interest**

Bay State has provided ample evidence that its proposed method of financing is in the

public interest. Financing through NiSource Financing Corp. will be far more favorable for the Company than a publicly bid financing. The interest rates for the Company's proposed financing would be similar to the rates that could be obtained with a public financing, however, the Company's proposed financing avoids significant transaction costs that would have to be incurred with a public financing. Tr. at 20-21. The Company will avoid underwriting commissions in the range of \$720,000 - \$780,000 as well as legal, accounting, auditing and rating agency fees in the range of \$225,000 - \$300,000, for total avoided transaction costs of \$945,000 - \$1,080,000. Ex. BSG-1, pp. 5-6; Tr. at 18-19. Furthermore, after one year there is no call or "make whole" premium if the Notes were to be redeemed by the Company before their maturity. Ex. BSG-1, pp. 5-6; Tr. at 19-20. Finally, financing through NiSource Finance Corp. permits far greater flexibility than a public financing as the Company can select the maturity most favorable at the time the Notes are issued and complete the financing in as little as two days, whereas a public financing would require approximately one month to close. Tr. at 25. An exemption from the requirements of G.L. c. 164, § 15 is appropriate, since it is consistent with creating overall lower debt costs for utilities.

## **V. CONCLUSION**

The Company requests that the Department (1) vote that Bay State Gas Company may issue and sell at face value to its affiliate, NiSource Finance Corp., unsecured Notes in an amount not to exceed \$120,000,000 and find that such Notes are reasonably necessary for legitimate purposes in meeting the Company's service obligations pursuant to G.L. c. 164, § 14; (2) find that the Company has satisfied the net plant test and that the fair structural value of the Company's property, plant and equipment and the fair value of its gas inventories will exceed its outstanding stock and long term debt, and accordingly vote that the terms of the proposed financing are in accordance with the provisions of G.L. c. 164, § 16; (3) grant an exemption from

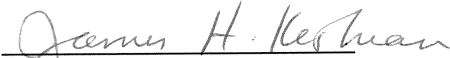


the competitive bidding requirements of G.L. c. 164, § 15; and (4) grant such other relief as the Department may deem appropriate.

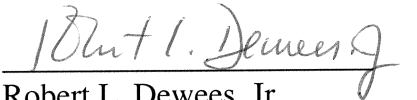
Respectfully submitted,

**BAY STATE GAS COMPANY**

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